



Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

CERTAIN CONSIDERATIONS IN RAILWAY RATE MAKING

By BALTHASAR H. MEYER

Of the Interstate Commerce Commission

It is my practice to preface remarks on occasions like this with the statement that I appear in a personal and unofficial capacity. No one who may be interested in proceedings pending, or which may hereafter be instituted, before the Commission of which I am a member, need have apprehensions that views and opinions expressed in this paper in any respect prejudice different views or opinions which he may wish to urge before the Commission, so far as I am concerned; and, of course, my colleagues on the Commission are not speaking through me on the present occasion.

Back In the Seminary Room.

I shall imagine myself back in the economics seminary room to open a general discussion on the subject of the making of railway rates. I shall, however, impose upon myself one restriction which the economic seminary is not always obligated to observe. This discussion will be directed in the light of existing laws and judicial interpretations and it will be founded upon the contemporary organization of society. I make this statement seriously, for I believe that it is well worth while for a properly conducted seminary in political economy to assume that certain constitutional and statutory restrictions, which may appear to stand in the way of what from a strict economic point of view seems desirable, should be removed for purposes of specific discussions, and an economic analysis made of the effect on human welfare of certain lines of action which could be pursued if these obstacles were not in the way. I regard this as a proper and efficient method of working out certain economic ideals and aims, which at some time in the future it may be possible to advance to the point of realization, and which, meanwhile, serve the stimulating purpose of hovering low in the horizon of the aspiring and patriotic young economist. The farther I get away from the class room, the more I am impressed with the value and possibilities of scientific economic instruction and research, conducted in a spirit of freedom and in the wholesome atmosphere of right-mindedness, in strict subordination to scientific method as applied to human welfare, with

absolute independence and fearlessness and proper consciousness of the limitations inherent in such work. Perhaps even more than in other fields of study, in economics the silent partner is a curse and a prejudice to humanity.

Limitations of this Paper.

I ask you also to please observe the restrictions suggested by the title of this paper. Every member of the association realizes the futility of attempting to hold up to view in a single discussion all considerations which enter into the making of rates. One may hope to succeed in calling attention to a few. There are those, possibly not among the membership of this body, who either have themselves or want others to get for them a definite and fixed standard of measuring a railway rate just as a tailor measures a piece of cloth. I, too, would like to have the yardstick if only I knew how and where to get it. I shall hope to be able to contribute a few constituents which must enter into the making of an approximate standard, at least a partial realization of which conditions of today permit. I must disappoint you, however, if you expect me to deliver it ready-made on this occasion.

Aim at Approximate Rate Standard.

Nevertheless, I believe it is possible to approximate a standard in rate making much more than has been done in this country in the past, but the kaleidescopic nature of the facts which enter into a particular rate problem will probably always defeat every attempt to impose a uniform rate rule upon the traffic of today throughout the United States. Were we standing at the threshold of the industrial epoch which brought the railway and modern manufactures, with none of the industrial relations of the contemporary structure of society established, a very different problem, and, consequently, also a very different solution, would be presented. The standard which I expect to see develop more rapidly in the future than in the past is a certain approximate standard applicable to normal or typical conditions from which variations will be made in the light of the concrete facts in each particular case.

The Rate Problem Perpetual.

This is not the first time that the Economic Association has devoted a part of its meeting to a discussion of railway questions,

as an examination of past programs will attest. In all probability, it will not be the last, for the question of railway rates embraces elements which are perpetual and which doubtless inhere in every industrial society which employs the railway as one of its instrumentalities. As long as rival individuals engage in trade, offering the same or competing commodities, placed upon the market by competing producers and sought by rival consumers, and any or all of these believe transportation charges to be excessive or discriminatory, the railway rate problem will continue to exist. The present system of private ownership and systems of regulation may give way to different systems of regulation, and these in turn may be superseded by a system of public ownership; but none of these will terminate rate controversies. Changes in ownership and systems of regulation and administration may eliminate some rate questions; they will with certainty originate others, and the rule or rules which suggest just settlements today may have to give way to other rules which the conditions of the future may require. The doctrine of relativity applies also to transportation.

Railway Rates and Import Duties.

In dealing with railway rates we come in contact with nationwide interests and forces, and, indirectly, and perhaps involuntarily, also with international forces. Under the law our appointed jurisdiction in the United States may stop with ocean, gulf and the 49th parallel; the economic effect of our action often goes far beyond. Considerations of this kind have led those foreign countries in which the railways are publicly owned to view their respective industrial policies as a united whole, of which the railway is a part. The administration of the railway is there made an instrument in shaping commercial policy. Railway rates and customs duties are frequently treated together, and rate-making is conducted in harmony with the customs policy of the country. In the United States, customs duties and railway rates have as a matter of law always been strictly divorced. Whether railways will be permitted in the future through the rates of transportation which they prescribe to augment or diminish the rate of import duty imposed by the federal government, only the future can reveal. It will probably depend upon the wisdom and discretion with which the power of making railway rates will be exercised in this respect.

Comparative Rates.

It has long been customary to establish rates in the light of certain checks and comparisons. This has apparently been done on the theory that if numerous other rates can be cited which are applicable on the same or similar traffic, under substantially similar circumstances and conditions, a rate in harmony with such illustrations is likely to be just and reasonable. Comparisons of this kind when restricted to small areas, such as a single state, are rarely satisfactory, but when they extend over a number of states, or embrace the entire United States, including numerous rates which are the result of competition between carriers, water and rail, while not necessarily determinative, are, nevertheless, of sufficient interest and value to command respectful consideration if not confidence. In the absence of better measures and checks this is one of the most useful expedients. Its intrinsic value depends, of course, upon the manner in which the rates drawn into the comparison have been selected, and the influences and forces which united in originally establishing them.

Competition in Rate Making.

This suggests the element of competition as one of the considerations in the making of railway rates. The members of the Economic Association are so thoroughly familiar with the general aspects of this feature of our problem that I shall not devote any time to it. There are survivals of the competitive rate, but the merest novice in the railway history of the leading countries of the world knows that competition alone has nowhere permanently secured to the public reasonably adequate service at reasonable rates, and that in consequence practically the world over the competitive theory of railway rate making has been abandoned. Where it does bring benefits to the public, competition is capable of producing better results than the best regulation. To what extent competition survives in railway rates or service today and what benefit the public may derive from it, lies outside of the scope of this paper.

Valuation and Securities.

Perhaps the most important single factor, now unknown, which will enter into the consideration of railway rates in the future is that of the value of the property. Theoretically, it has long been considered by commissions and courts, but in practice its appli-

cation has been limited to isolated valuations or partial valuations made under different, if not mutually exclusive methods, varying in degree of thoroughness and applied almost exclusively to meet allegations of confiscation of property. In the not distant future we may hope to know what the fair value or final value of our railway properties is, whatever these terms may be made to include. In the past attempt has been made to appeal to the volume and market value of outstanding securities with the view of having them considered as evidence of value to support a rate or rate structure under attack. In the future, after the valuations have been made, similar appeals can have little weight. Once the value of railway property has been officially established, and power to regulate service and rates coextensive with the railway business lodged with competent administrative authority, the issuance of securities by railway corporations becomes a question of public morals. The public eye should be directed toward the value of railway property as determined under the valuation statute rather than to the market value, face value, and number of pieces of paper which may have been circulated to represent the property. If there are people who prefer many pieces of paper, each with a smaller value, to fewer pieces of paper, each with a larger value, we may well permit them to gratify their whim, provided no burden is thereby imposed upon the rate paying public. As a matter of good morals we should prohibit as far as possible and make difficult the circulation of bad securities. We should legislate against the exploitation of the indiscriminating public when its speculative traits are appealed to, but under no circumstances should we recognize these engraved pieces of paper as the equivalent of property in the making of railway rates or, perchance, validate them through ill advised stock and bond legislation. The country urgently needs stock and bond legislation; but it will be better to have none than accept much of what is being proposed. What consideration, if any, should be given to securities issued in the past by railway companies in the valuation required to be made under the valuation act, is a matter which I cannot discuss with propriety at this time, and regarding which I shall express no opinion; nor should anything which I have said herein be construed as an intimation of what I believe the final conclusion upon this question ought to be. But what I am free to say is that, the task of valuation having been accomplished, outstanding securities against the valued property should not receive the least con-

sideration in the establishment of rates to be collected for the public use of that property. As suggested before, with adequate legal provisions and effective administration covering value of the property, service, and rates, the public has no interest in railway securities except as a matter of morals. These moral purposes should be promoted and achieved to the fullest extent possible through legislation, but great care must be exercised lest this legislation may by inadvertence or design make the value of securities a basis for rates with the possible consequence of imposing untold and utterly needless financial burdens upon the present and future generations of rate payers.

Cost of the Service.

A second factor equally fundamental with the value-of-the-property factor, which I believe will be employed very much more in the future, is that of the cost of the service. A great variety of statistical analyses have heretofore been made, but systematic efforts directed toward the ascertainment of the approximate cost of the service have, generally speaking, been strangely neglected. A small minority among those dealing with rate problems have long advocated it, but their plans have been thwarted by the skepticism and unwillingness of a persistent majority. There are those who have opposed the development of statistical investigations along the lines of cost because they assert the results are bound to be misleading and unreliable. Others confess a fear that information of that kind will be misused. Others declare that it will result in the establishment of rigid distance tariffs, with attendant chaos in the industrial world. Still others maintain the view that the cost of the service has nothing to do with the rate either in general or in particular. The combined weight and influence of all these objectors has thus far been sufficient to obstruct substantial progress.

Growth of Cost Accounting.

It is a fact of common knowledge that so-called cost accounting has been applied to every important branch of industry except steam railway transportation. A prolific literature upon the subject has been produced within the last decade, and competent specialists in all branches of business are prepared to give these principles practical application. The railways themselves have made limited application of the principles of cost accounting to

more than one half of the railway mileage in the United States. They declare, however, that this has been done for internal corporate administrative purposes rather than with a view of assisting in the establishment of just and reasonable rates. The difficulties of separating operating expenses among the various branches of the railway business are as apparent as the benefits of the final results are clear to those who are willing to undertake the task. It is perfectly obvious that controversy respecting the apportionment of maintenance-of-way items, for instance, can never end. Is this, however, sufficient reason for refraining from undertaking a work which is so promising in beneficial results? There exists surprising similarity in the methods employed by different railway companies in apportioning certain common or overhead expenses. This similarity appears to have been brought about without previous conference and agreement and is apparently the result of similar conclusions arrived at by men working at the same problem independently of one another. However, I am not suggesting that methods and rules which are now found to be common to several railway accounting departments are necessarily those which commissions should accept or prescribe. If cost accounting is not to be applied to railway transportation until every refinement has been settled by unanimous consent of the accountants, we shall never get anywhere. Institutional reforms are rarely effected from within and the railway is no exception. If such a rule were to be applied to the assessment and collection of taxes the government of every civilized country in the world would be obliged to cease its activities for want of revenue.

Practical Applications.

A new system of express rates is about to be put into effect throughout the United States. It inaugurates a revolution in the conduct of the express business. It is a carefully considered experiment, the exact outcome of which no one can predict with full confidence. How will anyone be able to draw a conclusion at the expiration of a definite period of time regarding the financial results of the operation of the express companies without approximating a segregation of the expenses incurred by the railroads on account of the express business? Railway mail pay is the object of periodical controversy. Does not that involve essentially the same fundamental accounting questions? Passenger rates are an

issue in different states in various parts of the country. How can these controversies be properly and justly settled without some reference to the cost of conducting the passenger business? One might suppose that the railways in this country would fairly vie with one another in producing the most scientific cost data in regard to their respective operations which the best talent can compile. With a few conspicuous exceptions, the exact contrary is the fact.

Joint Costs, Economy and Efficiency.

Before I leave the subject of cost of service kindly permit me to remind you of the impossibility of commenting upon such extremely important phases of the issues as are suggested by the words "by-products" and "joint costs," which have been so ably treated by distinguished members of this association. I must deny myself the pleasure of reviewing their work.

Furthermore, I have commented upon the cost of service as a consideration in rate making only. This entire paper might advantageously have been devoted to railway cost accounting as a test of efficiency and economy in operation; and after it has been ascertained what it actually costs to operate a railroad, a further inquiry into what it should cost to operate may profitably be instituted.

Controversy an Old One.

This whole controversy regarding the cost of the service is as old as the railway itself. Any method of separating expenses which may be adopted will at best leave much room for honest differences of opinion and the employment of varying, arbitrary factors. To my mind this situation resolves itself ultimately into the fundamental proposition that cost, being one of the elements to be considered in testing the reasonableness of a rate, must be ascertained as accurately as the nature of the problem will permit, otherwise it can not be considered. How can anyone give consideration to costs unless he knows what they are? Concluding that we must arrive at costs, it devolves upon reasonable men to elaborate workable rules and methods and employ the results with a full consciousness of their limitations. After the value of the property has been established, the cost of conducting the business approximated, and the value of the service considered, there will still remain a wide zone within which to exercise "the flexible limits of judgment."

Public Policy.

This leads me to remark briefly regarding a third fundamental factor which is influential in locating the point representing the rate within the zone of reasonableness, namely, that of public policy. The only public policy which the administrative branch of the government can officially know is the policy declared by the legislative branch through its statutory enactments. Legislatures set up the standards in accordance with which administrative bodies must measure rates; and regulative statutes generally leave ample room for the exercise of wise discretion. The public policy thus prescribed is expressed in most general terms, leaving the detailed applications to administrative action and judgment. It is not this kind of policy which, if my impressions are correct, people have in mind when they assert that the making of railway rates has nothing to do with the cost of the service, but that it is entirely a matter of public policy. I think that generally this statement emanates from the idea that rates are to be established at any particular time solely in the light of the available surplus of the railway corporation upon which the rate is to be imposed and the judgment or feeling of the rate maker regarding the real or supposed needs of different patrons or classes of patrons. If this is the proper basis for the making of rates the statistical analyses to which I have referred above are superfluous and should not be undertaken. All that is necessary under the operations of that kind of a public-policy-system of rate making is a balance sheet and an eye on the next election. It is ascertained how much money the railway company can spare according to its balance sheet, and then it is a matter of "policy" who shall get the benefit of the reduction or bear the burden of an advance.

Rates in Politics.

Nor is such a theory and practice of rate making without merit. An organization of society is conceivable in which it would be the very best system. It would be a perfect fit in an ideal society constructed upon this theory. In a patriarchal organization or society it might be the only proper system, for the patriarch would be presumed to know from whom to take and to whom to give. Our present organization does not represent this type of society. An attempt to impose such a theory upon a democratic organization of society must inevitably result in throwing the entire question of railway rates into politics. It will then be largely, if not en-

tirely, a question of clamor as to whether passengers shall ride at the expense of freight, whether wheat shall have the preference over cotton, live stock over lumber, coal over ore, vegetables over fruit, sugar over potatoes, rice over corn, etc. Obviously under such a system the available surplus will be dispersed—perhaps I should say, disbursed—in the direction of the loudest clamor and the largest vote. In a country like Prussia with its magnificent administrative traditions and machinery and far-sighted commercial and traffic statesmanship, an application of the patriarchal principle seems more readily conceivable, but even there rates are not made in just that way. While under a system of state ownership like the Prussian, public policy in any proper sense of the term may exert itself more directly and more liberally, this policy is certain to meet shipwreck anywhere if it does not embrace approximations of standards with which to test that policy from the point of view of railway operation. In other words, public policy is a framework, a background, interpretive in character, which should act as a guide in the application of more definite working rules in rate making.

Directing Rate Development.

There have been developed in the United States systems of rates with blankets covering two-thirds of the entire continent. Attempts have been made to break up these vast blankets, against which both common sense and reason instinctively rebel. But what is the standard toward which this breaking-up process is to be directed? Inordinately large groups have come into existence. If these are to be modified, by what measure is it to be done? The equalization theory of establishing rates for basal industries has been condemned. Along what lines are the new rates to be developed? The work of transforming these and other similarly indefensible features of rate making of the past to which reference has just been made all point in the direction of greater consideration for distance in future rate making. Transportation overcomes distance. Distance means expense. Shall distance have no weight in the establishment of the charge for that transportation? While no one who is at all familiar with the rates now in effect throughout the United States could for a moment reasonably consider the rigid application of a distance tariff to all traffic, it is equally apparent that many peculiarly knotty complications and controversies have already been settled through the application of a distance tariff, and that many more await a similar treatment in

the future. This being so, we find herein still another urgent reason for aggressively pushing investigations into the cost of the service.

Other Considerations.

The time limits wisely imposed by the Economic Association upon papers of this kind permit of reference only, without discussion, to the relation of freight rates to the classification of freight. The so-called elements of classification have been enumerated and discussed in numerous decisions readily available to all. From the standpoint of cost of service, classification resolves itself largely into ascertaining transportation costs and insurance risks. Instead of emphasizing volume of the traffic, it lays stress upon the balance of the volume of traffic in opposite directions. It inquires persistently into the utilization of car space and demands upon terminal facilities and generally acts as a unifying agent along defensible lines in the slow movement towards a uniform classification.

Value of the Service.

That indefinite term "value of the service" must also be separately named. "Classification" and "public policy" absorb the most of its content and "what the traffic will bear" may act as residual claimant. Those who are to follow me may attempt answers to questions relating to the value of the service, to whom? for whom? for what?

Why a Rate Yard-Stick can not be Delivered.

If I have succeeded in pointing out "certain considerations in railway rate making," they are the value of the property implying a fair return thereon, the cost of the service, and a sound public policy, each to be applied and interpreted in the light of the others and of all proper considerations whatsoever, through the exercise of a wise discretion in arriving at a judgment with respect to a particular statement of fact. The value of the property may be expressed in dollars in advance of any rate controversy. The rate of return may conceivably be established by fixed rules. The cost of the service may be approximated for any period of time and as of any date. Public policy may be outlined in general and specific language in legislative acts without reference to particular disputes. All the other considerations in rate making may

be indexed and catalogued for handy reference. But no one can state in advance the specific facts in a rate problem or controversy and the attendant circumstances and conditions. A certain combination of facts may require the application of a certain standard. A combination of facts similar to these but in different proportions may require a somewhat different standard. Instead of searching for one standard a set of standards may be sought, and that standard or combination of standards employed in each particular case which is best adapted to promote justice to all parties in interest. It is more important that justice shall be achieved in a large way than that some specific standard shall be promulgated and adhered to under all circumstances. That is why I cannot give you a universal rate yardstick but must content myself with directing attention to a few of its fundamental components.

The discussion having been opened, I now withdraw very reluctantly from the congenial atmosphere of the seminary in political economy.